



STATE OF CALIFORNIA

STATE BOARD OF EQUALIZATION

LEGAL DIVISION - MIC 82

450 N STREET, SACRAMENTO, CALIFORNIA

(PO BOX 942879, SACRAMENTO, CALIFORNIA 94279-0082)

Office No. (916) 324-2642

Fax No. (916) 323-3387

JOHAN KLEHS
First District, HaywardDEAN ANDAL
Second District, StocktonERNEST J. DRONENBURG, JR.
Third District, San DiegoBRAD SHERMAN
Fourth District, Los AngelesKATHLEEN CONNELL
Controller, SacramentoBURTON W. OLIVER
Executive Director

August 10, 1995

FAX

Dear Mr. :

This is in response to your letter to Richard Ochsner, Assistant Chief Counsel, Legal Division, dated June 15, 1995. You present the following fact situation.

Your clients invested in two vacant residential lots in San Francisco. In 1991, shortly after the soil was tested and the lots readied for construction, the property was condemned by the City of San Francisco. Your clients were unable to find vacant lots in San Francisco to replace the condemned property within the four year time period set out in Revenue and Taxation Code section 68, which would entitle them to adjust their base year value as set out in that statute. They replaced the condemned property with land with a residential building. You have not provided any additional information on either the original property or the replacement property.

You inquire as to whether the unimproved portion of the replacement property will qualify as comparable property to the vacant lots which were condemned. Based on the analysis set forth below and assuming that the unaddressed requirements are met, our answer is a qualified - yes. While not free from doubt, it is reasonable to conclude that a division may be made between land and improvements, and that tax relief is available on a pro-rata basis for the land based on the facts presented herein.

You have requested that we send copies of this letter to Mr. Verne Walton and Mr. Harry Quinn of the City of San Francisco.

LAW AND ANALYSIS

Revenue and Taxation Code sections 50 and 51 provide that the taxable value of real property is based on the base year value of the property. Properties purchased or changing ownership after the 1975 lien date are reassessed and base year values redetermined. "Change in ownership" is defined in Revenue and Taxation Code section 60 which provides that a "change in ownership" means a transfer of a present interest in real property, including the beneficial use thereof, the value of which is substantially equal to the value of the fee interest. Some transfers are exempted or excluded from consideration as changes in ownership. One such exclusion relates to the facts of this case.

The California Constitution, Article XIII A, Section 2(d) provides, in pertinent part:

"For purposes of this section, the term, 'change in ownership' shall not include the acquisition of real property as a replacement for comparable property if the person acquiring the real property has been displaced from the property replaced by eminent domain proceedings, by acquisition by a public entity, or governmental action which has resulted in a judgment of inverse condemnation. The real property acquired shall be deemed comparable to the property replaced if it is similar in size, utility, and function, or if it conforms to state regulations defined by the Legislature governing the relocation of persons displaced by governmental actions...."

As enacted by the Legislature, Revenue and Taxation Code section 68 implements Article XIII A, Section 2, subdivision (d); that statute similarly defines the term "change in ownership" and addresses matters other than the comparability of the acquired/replacement property to the original/replaced property. Property Tax Rule No. 462.5¹ (attached hereto) was promulgated by the State Board of Equalization pursuant to its authority under Government Code section 15600 to implement Revenue and Taxation Code section 68.

¹Property Tax Rules are set out in Title 18, California Code of Regulations.

Property Tax Rule No. 462.5 provides in part:

"(a) **GENERAL.** The term 'change in ownership' shall not include the acquisition of comparable real property as replacement for property taken if the person acquiring the replacement real property has been displaced from property in this state by:

- (1) Eminent domain proceedings instituted by any entity authorized by statute to exercise the power of eminent domain, or
- (2) Acquisition by a public entity, or
- (3) Governmental action which has resulted in a judgment of inverse condemnation.

"(b) **DEFINITIONS.** The following definitions govern the construction of the words or phrases used in this section.

- (1) 'Property taken' means both property taken and property acquired as provided in (a).
- (2) 'Replaced property' means real property taken.
- (3) 'Replacement property' means real property acquired to replace property taken.

* * *

It appears that the transactions as described fall within the meaning of subdivisions (a) and (b) and meet those threshold requirements. We note that subdivision (b) defines both the "replaced property" and the "replacement property" to mean "real property . . .". "Real property" is defined in Revenue and Taxation Code section 104 to include both land and improvements.

Subdivision (c) of Rule 462.5 addresses comparability; the issue of comparability is the critical issue in this case based on the facts presented. The replaced (original) property was vacant land and the replacement property is land with a building, ie., land and an improvement. Rule 462.5, subdivision (c) provides:

"(c) **COMPARABILITY.** Replacement property, acquired by a person displaced under circumstances enumerated in (a), shall be deemed comparable to the replaced property if it is similar in size, utility, and function.

(1) Property is similar in function if the replacement property is subject to similar governmental restrictions, such as zoning.

(2) Both the size and utility of property are interrelated and associated with value. Property is similar in size and utility only to the extent that the replacement property is, or is intended to be, used in the same manner as the property taken (i.e., single-family residential and duplex, multi-family residential other than duplexes, commercial, industrial, agricultural, vacant, etc.) and its full cash value does not exceed 120 percent of the award or purchase price paid for the replaced property.

(A) A replacement property or any portion thereof used or intended to be used for a purpose substantially different than the use made of the replaced property shall to the extent of the dissimilar use be considered not similar in utility.

(B) A replacement property or portion thereof which satisfies the use requirement but has a full cash value which exceeds 120 percent of the award or purchase price shall be considered, to the extent of the excess, not similar in utility and size.

(3) To the extent that replacement property, or any portion thereof, is not similar in function, size, and utility, the property, or portion thereof, shall be considered to have undergone a change in ownership.

EXAMPLE: A home is replaced by a combination dwelling and commercial property. Relief is applicable to only the dwelling portion of the replacement property; the commercial portion shall be considered as having changed ownership.

EXAMPLE: A combination dwelling and commercial property is replaced with a home. Only the dwelling portion of the property taken shall be considered in determining the comparability and the amount of relief. The right to relief on the commercial portion of the property taken is waived unless comparable replacement commercial property is acquired after the date of displacement and a timely request is made for assessment relief.

EXAMPLE: A combination dwelling and commercial property is replaced with a home, and later the displaced person also acquires a separate comparable replacement commercial property. Pro-rata relief shall be granted on both the replacement home and commercial property to the extent provided in subdivision (b)(1).

* * *"

Rule 462.5, subdivision (c) requires that the replacement property shall be deemed comparable if it is similar in size, utility, and function. Subdivision (c)(1) provides that the property is similar in function if the replacement property is subject to similar governmental restrictions, such as zoning. You have not provided any information about either the original property or the replacement property as to governmental restrictions. We note that what constitutes sufficient similarity of restrictions is a decision that the assessor will make based on an evaluation of all the facts.

Subdivision (c)(2) provides that size and utility of property are interrelated and associated with value. You have not provided any information about either property related to size or value. As the monetary value of this tax exclusion is limited by statute and by Rule 462.5, subdivision (c)(2)(B), we will assume for purposes of discussion that value and size are not critical factors in this analysis. These also, however, will be decisions that the assessor will make based on evaluations of all the facts.

Subdivision (c)(2) continues on and distinguishes the utility of residential or commercial property from the utility of vacant land. Thus, the replaced (original) property is dissimilar in utility from the replacement property insofar as there is an improvement on the replacement property. However, subdivision (c)(2)(A), together with the examples set forth in subdivision (c), indicate that a pro-rata division of an appraisal unit may

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be considered with regard to similar and dissimilar utility when determining comparability. Thus, in the facts under consideration herein, in our view, relief would be applicable to only the land portion of the replacement property. Arguably, the land portion of the replacement property should not be considered to have undergone a change in ownership on the basis that land without an improvement is comparable to vacant land.

Subdivision (c)(3) provides that to the extent replacement property is not similar in function, size and utility, the property, or portion thereof, shall be considered to have undergone a change in ownership. Thus, the improvement portion, in the facts under consideration herein, shall be considered as having changed ownership.

We have previously advised that the assessor should keep in mind the underlying intent of the constitutional provision cited above; it was designed to correct an inequity that may occur when a governmental agency forces a property owner to relocate to make way for a public project through eminent domain proceedings, public entity acquisition, or inverse condemnation. The displaced property owner should not be faced with the unpleasant consequence of a tax increase after a government-caused relocation. Thus, the exclusion from change in ownership related to base year value was adopted. However, the constitutional provision was not intended to provide a benefit to the displaced owner; it was intended to compensate for a loss, and certain requirements and limitations were put in place.

Subsections (d) through (h) of Rule 462.5 relate to other aspects of this exclusion, i.e., procedures for determining the adjusted base year value, ownership requirements, new construction required to make replacement property comparable, time limits for qualification, and administration. You have not raised any question as to these aspects, and we will not address them except to note that the additional requirements therein must be met.

In summary, it is our opinion that based on the facts and law discussed herein, Rule 462.5 allows relief to only the land portion of the replacement property; relief should be calculated as provided in subdivision (c)(2) of the rule with regard to the land value of the replacement property in relation to the value of the replaced (original) property (i.e., the vacant lots).

The views expressed in this letter are, of course, only advisory in nature. They are not binding upon the assessor of any county. You may wish to consult the appropriate assessor in

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order to confirm that the described property will be assessed in a manner consistent with the conclusions stated above.

Our intention is to provide timely, courteous and helpful responses to inquiries such as yours. Suggestions that help us to accomplish this goal are appreciated.

Sincerely,

/s/ Janet Saunders

Janet Saunders
Tax Counsel

JS:jd
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Attachment

cc: Honorable Doris Ward
Assessor
City and County of San Francisco
875 Stevenson Street, Third Floor
San Francisco, CA 94103

Mr. Verne Walton
Chief Assistant Assessor
City and County of San Francisco,
875 Stevenson Street, Room 320
San Francisco, CA 94103

Mr. Harry Quinn
Assistant Director of Property
San Francisco Real Estate Department
25 Van Ness Avenue, Suite 400
San Francisco, CA 94102

Mr. John Hagerty, MIC:62
Mr. Richard Johnson, MIC:64
Ms. Jennifer Willis, MIC:70